

## **HIGH YIELD INVESTMENT FRAUD aka PRIME BANK FRAUD**

by William C. Kerr  
National Bank Examiner, Fraud

High Yield or Prime Bank fraud can be traced back to several origins. Its roots originated in ancient history, along with the origin of interchangeable money. This is followed by a long history of advance fee fraud concerning commodities, loans, and securities. With varying degrees of sophistication, promoters have for years promised access to low interest rate loans or cheap securities in exchange for the payment of an up-front fee. High yield investment fraud is the twentieth century's version of Alchemy, the process of creating something valuable out of nothing. While ancient Alchemy tried to convert lead to gold, the modern version sells nonsense for cash.

In the 1980s, with the advent of publicly available electronic transactions, offers for the sale of world currencies, "Prime Bank Notes" and low interest rate loans grew rapidly, supplementing the offers published for years in the world's financial journals. Both sources also offered securities (or collateral) listing a number of different types, with Prime Bank Notes (PBN) being the most important. These PBNs were also stated to be issued by the world's leading banks, to further the aura of financial credibility. The PBNs came in two standard maturities and rates. There were 10 and 20 year 7.5% notes, and, 10 and 20 year 14% notes, but the 7.5% 10- year notes were the favorite, and remain so today in the form of 7.5% Medium Term Notes.

At this time, many of the longer term securities were supposed to have originated in Japan. "Japanese notes" were so named because Japanese banks were king of the hill in international banking at that time, giving them an aura of superior strength. Bank of China notes were also occasionally seen, but usually guaranteed by one of the leading international banks.

A closely related fraud, combining both situations, is the self-liquidating loan. Former Senior National Bank Examiner and founder of the OCC's Offshore Banking and Fraud Section, John Shockey, recalls self-liquidating loan proposals from the 1950's and the onslaught of the Prime Bank Frauds in the 1970's with its subsequent evolution into the current Bank Trading Programs. The current schemes supposedly use Bank Debentures, U.S. Government securities, or other highly rated securities.

In addition to PBNs, the con artists also offer, for investment purposes, the one year Standby Letter of Credit (SLC). The prices offered for these instruments are normally in the 80-85% range for the fake SLCs and in the 70%-80% range for the equally worthless 10 year 7.5% PBNs. By the standards of any time period, this is unbelievably cheap, so unbelievably cheap that little credibility was given to the possibility that investors could be gullible enough to be taken in, at first. A large number of people kept touting these instruments, and years later it was not a surprise to learn of their criminal records and that many later ended up being arrested for their activity.

One of the key drivers in the continuing life of high yield investment fraud is its ability to transform into the latest financial innovation of the day. Whether the financial news organizations talk about zero coupon bonds, the Sudan, Afghanistan, swaps, Iraq, Belgium or the United States, the countless offers for the purchase and

sale of the currency or securities of the country, or the latest financial instrument in the news, will dominate the fake markets. In all these transactions, the quantities offered are fantastic, in the millions, billions and trillions of dollars. Thousands of offers for relatively unknown currencies and securities are made, but none of these transactions ever close.

Continuing the expansion of fake financial instruments available, a new instrument appeared on the scene sometime during this time that expanded the market substantially: the Prime Bank Guarantee (PBG). The PBG is similar to the PBN in terms of interest rate and maturity, but was priced higher because they supposedly had a higher priority among creditors in the event of bankruptcy.

PBGs became the first choice of the con artists. The simple fact that guarantees, like letters of credit, are not investment instruments did not stop the cons from offering them. The most popular guarantees had stated "6%, 7%, or 8% interest rates". These are commonly referred to respectively as: "106s," "107s," and "108s."

Along with the fictitious securities, came a long list of terms used to describe where and how these "investment securities" originated. While you could not find any reference to these types of "investment securities and terms" in legitimate financial circles, many people didn't care where or why they were issued. Sources were listed as "cutting houses" pursuant to a "master collateral commitment." Where was the location of such cutting houses, and if the securities were issued by recognized financial institutions, why was the source not the bank? This "inside knowledge" and sources were secrets known supposedly only to a few select persons.

"Master collateral commitments" and "contracts" were circulated, but they were very sloppily drafted, containing numerous typing mistakes, re-faxed with important information whited-out, or obvious forgeries. The quality of the paperwork did not match the multi million dollar level of the deals nor the level of sophistication of the reported originating institutions.

In addition, a simple purchase and sale, of a supposed investment security, was organized in such a way as to resemble a multibillion dollar transaction between several parties. This complex structure for a simple transaction is a key hallmark of the High Yield Investment Program scheme (HYIP). Additionally, the proposal is rarely for one transaction, with the "program" continuing to run each week until the end of the program, typically 40 weeks. The typical HYIP has the intermediary working with the broker, who then works with the program manager, who works with the mandate, who then works with the commitment holder, who works with the trader, who of course is secret and only one of the \_\_\_\_ (pick your number- 5,7,25) who has access to this fabulously lucrative market.

The modern program further attempts to give credibility to the transaction by stating that it is guaranteed by the United States Federal Reserve System and your investments can be checked with your Cusip or transaction number on a Bloomberg or Euroclear screen. Sometimes an additional inducement is offered by the con artist in the form of a "blocked funds account" or "blocked funds letter" structure to assure investors their money would not be stolen. While the current terminology has changed to non depletion accounts, reserved in the account, or making the funds available for scanning in the account, the underlying false assertion has not changed and investors still lose money through these schemes.

What really happens in every one of these programs is, the instant you put any money into an account or provide the information about your account to the con artist, your money will be wired offshore/somewhere to pay for your trips to check on the investment, and all of their parties, house mortgages, boats, cars, and diamond jewelry.

The history of the up-front-fee scheme in the form of HYIP, bank debenture trading programs, prime bank instruments, and self liquidating loans is based on old-fashioned greed and dishonesty. It is basically the time immemorial, "getting something for nothing," which the con artists have always been willing to provide.

The schemes have nothing to do with world monetary conferences such as Bretton Woods, the G-8, the Bank for International Settlements, the Federal Reserve, or humanitarian programs. There are no secret markets available only to the chosen few. It is fraud. The story has changed, the justifications evolve to match current events, but the end result is always the same: investors lose money.